

Bankruptcy Sales Free and Clear of Liens and Back Chain Creditors' Rights Issues

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I. Bankruptcy Sales Free and Clear of Liens

11 USC §363

- §363 (f) of the Bankruptcy Code allows the non-exempt real property to be sold free and clear of existing liens.
 - Theory behind allowing such sales
 - What happens to the lien?

11 USC §363

- Three general categories of sales where sales made free and clear of existing liens may occur:
 1. Pre-Confirmation sales that generate enough proceeds to full pay all of the secured creditors;
 2. Pre-Confirmation sales that do not generate enough proceeds to full pay all of the secured creditors; and
 3. Post Confirmation sales.

Must be based on at least one of the following five elements found in 11 USC §363(f)

The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if--

1. applicable non bankruptcy law permits sale of such property free and clear of such interest;
2. such entity consents;
3. such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
4. such interest is in bona fide dispute; or
5. such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Applicable Non-Bankruptcy Law

- 11USC §363(f)(1)
 - Authorizes sale free of liens and interest when applicable non bankruptcy law permits it.
 - Rarely used in connection with real property transactions.

Consent to Sale

- 11USC §363(f)(2)
 - Authorizes a sale free of liens and interests when the holder of the lien or interest consents to the sale.
 - The consent contemplated is the consent to the sale of the asset free and clear of liens and interests, and not merely consent to a sale of the asset.

Sufficient Sale Price

- 11USC §363(f)(3)
 - Authorizes a sale free and clear of liens when the sale price exceeds the value of all liens on the property.
 - Courts are divided on the interpretation of this provision.
 - What exactly is meant by the phrase “aggregate value of all liens”?

Interest in Bona Fide Dispute

- 11USC §363(f)(4)
 - Authorizes the sale free and clear of liens and interests when such interest is in bona fide dispute.
 - Generally, the burden of proof to prove bona fide dispute rests with the trustee, or DIP.

Compelled to Accept a Money Satisfaction

- 11USC §363(f)(5)
 - Authorizes the sale free and clear of liens and interests when such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
 - Does this provision make the other four provisions irrelevant?
 - See, Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25 (B.A.P. 9th Cir. 2008)

Mixing and Matching § 363(f) Provisions

- §363 (f) is written in the disjunctive, meaning the sale free and clear of liens may be effectuated if any one of the elements of §363 (f) has been met.
 - Does that mean that you can use two or more elements in combination to achieve a result that could not be obtained with the use of only one element?

Obtaining the Court Order

- Motion must be served on all parties whose interests will be effected.
 - A proper analysis requires more than just a review of the various Schedules filed with the Bankruptcy Petition.
 - The title records must also be searched and then compared against the Bankruptcy Schedules.

Appeal

- Orders to sell property free and clear are appealable
 - Period within which to file an appeal is 14 days from the date the Order is entered.
 - What about Orders issued under §363(m)?
 - §363(m) specifically reads as follows:

“reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.”
- Sale of property cannot be reversed on appeal or can it?
 - See, Clear Channel Outdoor, Inc. v. Knupfer, 391 B.R. 25 (B.A.P. 9th Cir. 2008)

Questioned Authority of Bankruptcy Courts

- Does the Bankruptcy Court have the jurisdictional authority to issue a free and clear Order when the sales proceeds are insufficient to fully pay all secured creditors? If not, can jurisdiction be conferred a creditor's actions in a bankruptcy proceeding?
 - Stern v. Marshall, 131 S. Ct. 2594 (2011);
 - Waldman v. Stone, 698 F.3d 910 (6th Cir. 2012);
 - In re Bellingham Ins. Agency, Inc., 702 F.3d 553 (9th Cir. 2012); and
 - Wellness International Network, Ltd v. Sharif, 727 F.3d 751 (7th Cir. 2013)

Checklist for Pre-Confirmation Sales Free and Clear

1. Review Commitment to determine Parties with liens on real property;
2. Review Bankruptcy Matrix to determine if all parties with liens on real property have been listed as creditors;
3. Determine if all lien holders were given Notice of Motion;
4. Does the Order for Sale specifically reference the 11 USC § 363(f) provision which allows the property to be sold free and clear of liens;

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Checklist for Pre-Confirmation Sales Free and Clear

5. Does the Order for Sale reference a business purpose and/or necessity to sell the property prior to a Confirmed Plan;
6. Determine if the Order for Sale specifically identifies the property being sold;
7. Determine if the Order for Sale establishes a reserve for mechanic's liens (if needed);
8. Determine if the Sale Price is sufficient to fully compensate all secured creditors;

Note: If funds are insufficient, you may have a Stern vs. Marshall issue and further inquiry will be needed.

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Checklist for Pre-Confirmation Sales Free and Clear

9. Determine if the 14 Day Appeal Period has run from the date of the Order with no appeals having been filed;
10. If an Appeal has been filed, determine if a Stay of the Order Pending the Appeal has been entered;
Note: If Appeal has been filed but no Stay Pending Appeal – this creates a 9th Circuit Clear Channel issue and an appropriate exception must be taken.
11. Collect all necessary Transfer Taxes. Unless State law specifically authorizes otherwise, payment of transfer taxes is required in a Pre-Confirmation Sale. (See, Florida Dept. of Revenue v. Piccadilly Cafeterias, Inc. 554 U.S. 33, 128 S.Ct. 2326); and
12. Obtain a certified copy of the Order for Sale and record it along with all other necessary transactional documents.



II. Back Chain Creditors' Rights Issues

Hidden Problem

- The 2006 Policy forms all contain an exclusion for creditors' rights issues
 - See Section 4 in the Exclusions from Coverage portion of the Owner's Policy and Section 6 in the Exclusions from Coverage portion of the Loan Policy.
 - So what's the concern?

Concern

- To understand the concern, you need to read the Policy exclusions closely:
 - The Owner's Policy reads: "Any claim, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws, **that the transaction vesting the Title as shown in Schedule A...**"
 - The pertinent part of the Loan Policy reads: "**...that the transaction creating the lien of the Insured Mortgage...**"

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Concern

- The exact language of the Policy Exclusions only pertain to the specific transaction being insured.
 - If the sale of Blackacre from A to B will result in an Owner's Policy in favor of B, the Exclusions from Coverage only pertain to any creditors' rights issues which may arise out of that transaction.
 - Issues arising out of the prior sale of Blackacre to A are not excluded.

How Back Chain Issues Arise

- Typically arise in the context of a bankruptcy as either:
 - A. A Preference under §547 of the Bankruptcy Code; or
 - B. A Fraudulent Transfer under §548 of the Bankruptcy Code.
- They may also arise under the State's the fraudulent conveyance statutes.

Preference Issues §547

- §547 gives the Bankruptcy Trustee the power to avoid any transfers made by the debtor within 90 days of the filing of the bankruptcy petition.
 - This 90 day “look back window” is extended to 1 year if the transfer is made to what the Bankruptcy Code considers to be an “insider”.
 - Transfers made within the appropriate look back window are presumed to be a preference.

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Preference Issues §547

- Measuring the 90 day look back period
 - Look to date of instrument **and** date of recording.
 - Transactions closed prior to the 90 day window but recorded within the 90 day window could be trouble.
 - 30 day recording window

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Preference Issues §547

- 4 Elements needed to establish a Preference:
 1. The transfer was made to or for the benefit of a creditor;
 2. The transfer was made on account of an antecedent debt;
 3. The transfer was made at a time when the debtor was insolvent; and
 4. The transfer enabled the creditor to receive more than it would have received under a Chapter 7 liquidation.

Fraudulent Conveyance §548

- A single transfer can also be challenged as fraudulent conveyance under §548 of the Bankruptcy Code.
 - Two types of fraudulent transfers:
 1. Actual Fraud – Requires specific intent; and
 2. Constructive Fraud – Seller received less than reasonably equivalent value **and** the debtor was insolvent or made insolvent by the transfer.

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Fraudulent Conveyance §548

- Look Back Period
 - Federal:
 - Two years from the date the Bankruptcy Petition is filed.
 - State:
 - Varies from two years to ten years.
 - Although most states, including Alabama, have adopted the Uniform Fraudulent Transfer Act which has a 4 year look back period, the look back period in Alabama is from one year to ten years depending on the type of fraud.

See, Ala. Code Ann. §§ 8-9A-1 through 12

Real World Situations

- Deeds in Lieu of Foreclosure
 - What was the value of the property on the date of the transfer to the creditor?
 - Was it more than the amount owed on the outstanding debt?
 - Other non-creditors' rights concerns with deeds in lieu:
 - Merger
 - A Deed in lieu does not automatically merge the fee interest and mortgage interest. (See, Ala. Code §§35-10-50 and 35-10-51)

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Real World Situations

- Necessary exceptions
 - A Schedule B exception for the mortgage must be included in any policy to be issued if the mortgage is not properly released of record.
 - If the title search reveals the existence of any junior liens, those liens must continue to be shown as exceptions.

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Real World Situations

- Recharacterization Issues
 - Determining if the deed in lieu is really an equitable mortgage
 - Examine the structure of the transaction
 - Does it appear that the parties intended the conveyance to be an absolute deed or does it appear to be acting more as security for the debt;
 - Do the transaction documents contain a repurchase option;
 - Does the debtor have the right to remain in possession after the deed is given; and
 - Determine if an estoppel certificate has been provided by the debtor.

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Real World Situations

- Mortgage Foreclosures
 - Did the foreclosure result in an equity transfer?
 - BFP v. Resolution Trust, 511 U.S. 531, 114 S.Ct. 1757 (1994);
 - In re Villarreal, 2009 WL 2601298(Bkrtcy.S.D.Tex.)

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Real World Situations

- No consideration transfers to a related party or a Special Purpose Entity.
 - Need to determine why this was done
 - At the request of the lender
 - For estate planning purposes
 - Transfer of title to avoid creditors.
- No consideration transfers accompanied by a non-purchase money mortgage.

Assessing the Risk

- Factors to Consider
 - The age of the questioned transfer
 - Financial wherewithal of the transferee
 - Was the transfer made at the request of a lender that is now being insured
 - Underlying purpose of the transfer
 - Existence of lawsuits, judgments or liens occurring in the same time period as the transfer

Title Exception

- If a back chain issue is noted, the following exception must be taken in Schedule B regarding the transfer:
 - Any claim which arises out of the transfer from _____ to _____, dated _____ and recorded on _____ in Book _____, page _____, by reason of the operation of federal bankruptcy, state insolvency, or similar creditors' rights laws.
 - NOTE: Removing this exception will require Underwriter Approval



THANK YOU